RB-2006-01 Oversight by Board of Directors

Management Oversight by the Board of Directors

INTRODUCTION

As the credit union movement continues to evolve, the duties of directors are becoming more complicated and demanding. In addition, the recent corporate scandals and the Sarbanes-Oxley Act have raised public awareness in the area of corporate governance. Today's board of directors must take an active role in shaping and controlling a credit union's business operations and risks. The following briefly highlight the basic responsibilities the board has in actively overseeing the credit union's affairs:

- Establish goals, standards, policies and procedures, and operating strategies and understand the risks involved in following certain strategies.
- Establish a compliance program emphasizing the importance of regulatory compliance as an inherent part of credit union operations, ensuring compliance with external standards, such as laws and rules, and the credit union's own policies and procedures.
- Hire and retain the managing officer (president) with the skills, integrity, knowledge, and experience appropriate for the nature and scope of their responsibilities and periodically evaluate management's performance.

- Review audits, examinations, operating results, compliance performance and performance of new and existing activities.
- Ensure that the credit union serves the credit needs of its members.

Of these basic responsibilities, a board's most important responsibility is to select a capable president (manager) for the credit union.

HIRE AND RETAIN COMPETENT MANAGEMENT

Although economic conditions are a major influence on a credit union's well being, the most important factor in the success of a credit union is the quality of its management. It is rare that the cause of a serious problem or the failure of an institution is for reasons other than mismanagement. Most credit union failures are the result of inattentive, inadequate, or dishonest presidents. Therefore, a safe and sound credit union usually is the result of talented and capable management, which has the ability to manage day-to-day operations to achieve the credit union's performance goals. Such management has the industry expertise to help the board plan for the credit union's future in a changing and competitive marketplace, as well as generate new and innovative ideas for board consideration. It has the technical expertise to design and administer the systems and controls necessary to carry out the credit union's policies, to manage risks, and to ensure compliance with laws and rules.

When a credit union hires a president, the Board must actively manage the selection process. Selection criteria should include integrity, technical competence, character, and experience in the financial services industry. The board's choice for a president should share the board's operating philosophy and vision for the credit union to assure that mutual trust and a close working relationship are maintained.

COMPENSATION

Credit unions need to offer competitive compensation packages to hire and retain qualified management.

The Department recognizes that many credit unions feel they are at a disadvantage in competing for talent with other financial institutions who have more flexibility with compensation arrangements (e.g., granting stock options). The Department also recognizes that credit unions may use a combination of higher salaries, bonuses, and benefits to overcome this disadvantage.

The Department will ordinarily give healthy credit unions deference concerning compensation arrangements for their president provided the arrangements are reasonable and do not present significant safety and soundness concerns that could lead to material financial loss or damage to the credit union. For purposes of this bulletin, compensation includes any payment of money or provision of any other thing of value in consideration of employment, including, without limitation, base salary, bonuses, pension plans, severance payments, retirement, fringe benefits, payment of expense items without accountability or business purpose or that do not meet the IRS requirements for deductibility by an organization.

In determining the compensation of its president, the board of directors should consider at least the following factors:

- The qualification and experience of the president.
- The compensation paid to person having similar duties and responsibilities in other credit unions.
- The size of the credit union and the complexity of its operations.
- The financial condition, especially capital position and income level, of the credit union and the president's contribution to the credit union.

- Any other amounts the president receives, either directly or indirectly, for other services performed for the credit union.
- The value of personnel fringe benefits provided to the president, and perquisites such as an automobile, club membership, and expense account.

An increasing number of businesses today rely on incentive pay to motivate management to excel. The Department has no problem with incentive-base compensation but will object to any arrangements that provide incentives contrary to safe and sound operations of the credit union. For example, compensation based primarily on short-term operating results may encourage unreasonable risk-taking to achieve short-term profits. The board should closely monitor compensation tied to current operating results.

ENSURE QUALIFIED MANAGEMENT

The board should give the president the latitude he or she needs to run day-to-day operations; however, the board should implement a formal performance appraisal process to evaluate management's performance. Such a process helps to assure that periodic evaluations take place and demonstrates that the board is discharging it responsibility to supervise management. Performance appraisals should evaluate criteria relevant to the position, such as:

- The credit union's record of complying with laws and regulations.
- Criticisms contained in audit, examination reports, and member complaints and their resolution.
- Management's responsiveness to board directives, including compliance with board-approved policies.
- The timeliness, quality, and accuracy of management's recommendations and reports.

- Management's progress in implementing the credit union's strategic plan.
- Management's presentations to the board.
- The credit union's business success, including business performance indicators, such as actual versus projected performance, comparative credit union performance, and peer group comparison.

Although the board will only directly review the performance of the president, it should consider requiring performance appraisals by management for all other credit union employees. That will help it have strategies to retain competent management and staff, including compensation and benefit packages and succession. While the board should generally avoid reviewing and setting the specific compensation of employees other than the President, it should approve and periodically review the credit union's overall compensation package. Although compensation and benefit packages should be appealing, they should contain reasonable terms and conditions and not discriminate against any individuals or groups. They must not be excessive or lead to material financial loss for the credit union. While the board may want to consider the compensation and benefit packages of similarly situated credit unions, the board should tailor the compensation package to the credit union's size, its financial condition, and the nature, scope, and complexities of its operation.

The board should develop appropriate succession and transition strategies to address the loss of the president and other key positions. These strategies should identify critical positions and qualified potential replacements, including interim replacements. If no individual in the credit union is suitable, the succession strategy should identify a temporary replacement who could serve until the board finds a qualified successor. The board should review these contingency plans annually to determine if they remain workable.

If the board becomes dissatisfied with the performance of the

president, it should address the matter directly. If the board needs to dismiss the president for poor performance, dishonesty, conflicts of interest, or for other reasons and it fails to do so, this failure may represent a serious breach of the board's responsibilities.

CONCLUSION

Change in the financial marketplace has created a more competitive and challenging environment for all credit unions. As a consequence of this change, the role of the credit union board members has grown in importance and complexity. The long-term health of a credit union depends on a strong, independent, and attentive board, which has placed the day-to-day operations of the credit union in the hands of qualified and competent management.